





From The Director

On behalf of the Montana Lottery Commission, Staff, and Retailers, I am pleased to present our 20th Anniversary Annual Report. Our 20th Year was a very successful year. Sales exceeded \$40 million for the first time in the Montana Lottery's history. In addition, transfers to the State of Montana exceeded \$11 million, a 25 percent increase over last year, and \$2 million more than our previous record transfer in Fiscal Year 1994.

Fiscal Year 2007 was a year of significant achievements. Sales of Scratch products increased ten percent over last year, primarily because the \$10 ticket has taken hold in the marketplace, and has offered Scratch players another option for some scratching fun. Montana Cash, Wild Card, Hot Lotto and Qwik Tix sales all increased, and sales overall were up four percent over last year.

Powerball sales, although down from last year, were strong. The strength of Powerball sales rests on the success of Power Play, an option which, for an extra \$1, will increase prizes paid, except the jackpot, by two to five times. Nearly twenty percent of Powerball sales are Power Play sales. This translates into over \$2 million in sales last year, and reduces the Lottery's reliance on mega-jackpots to sustain Powerball sales.

In addition to our successes in Fiscal Year 2007, this report is an overview of significant achievements for twenty years. The Montana Lottery is a responsibly run business which provides funds for important state programs, while offering Lottery games for Montanans that are fun and secure.

From June 24, 1987, when we sold our first Scratch ticket, we have raised more than \$140 million for important state programs, paid more than \$35 million to the retailer partners who sell our products, and paid out more than \$309 million in prizes.

With continued support of our retailers and players, the Montana Lottery will persist in our efforts to provide fun and entertainment for the people who play our games, while operating responsibly to raise money for important state programs.



Sincerely,

George Parisot
Director

Lottery Products



- Fiscal Year 2007 sales totaled \$12.4 million.
- The Montana Lottery introduced 45 different Scratch games in Fiscal Year 2007.
- Prizes paid in Fiscal Year 2007 totaled \$7.3 million, an overall prize payout of 59.2%.
- Of these prizes, 100 winners won a prize of \$1,000 or more, with the top prize won of \$50,000.
- Each Lottery retailer receives a 5% commission on gross sales, with the potential for earning additional commissions on sales over base. Retailer commissions in Fiscal Year 2007 totaled over \$1 million, or 8.2%.



- Played in 31 Lottery jurisdictions including Montana.
- In Fiscal Year 2007, Powerball sales totaled nearly \$17 million.
- For an additional \$1 per play, players can choose to add Power Play to their ticket, which gives winners a chance to multiply their prize, except the jackpot, up to five times. Power Play sales now total approximately \$2 million per year, and average 15% of total sales.
- Powerball prizes paid in Fiscal Year 2007 totaled almost \$8 million, and the overall prize percentage was 47%.
- Total number of winners in Fiscal Year 2007 was approximately 73,000, including three \$200,000 winners, and 21 \$10,000 winners. Two of the \$10,000 winners added Power Play to their ticket, making their prizes worth \$20,000 on March 14, 2007, and \$30,000 on May 12, 2007.
- Each Lottery retailer receives a 5% commission on gross sales. Retailer commissions in Fiscal Year 2007 totaled nearly \$850,000.



- Played in Montana, Idaho, North Dakota and South Dakota.
- In Fiscal Year 2007, there was one Montana Jackpot winner for \$1.1 million, sold in Helena for the August 16, 2006 drawing.
- In Fiscal Year 2007, Wild Card sales totaled \$3.2 million.
- Wild Card prizes paid in Fiscal Year 2007 totaled approximately \$1.5 million.
- In Fiscal Year 2007, overall prize percentage for Wild Card was 48.1%.
- Each Lottery retailer receives a 5% commission on gross sales. Retailer commissions in Fiscal Year 2007 totaled nearly \$158,000.



- The game features frequent jackpot winners—15 Jackpot winners in Fiscal Year 2007.
- The highest jackpot won in Montana for Fiscal Year 2007 was \$280,000, sold in Cut Bank for the January 10, 2007 drawing.
- In Fiscal Year 2007, Montana Cash sales totaled \$4.7 million.
- Montana Cash prizes paid in Fiscal Year 2007 totaled \$2.4 million, and the overall prize percentage was approximately 52.1%.
- Each Lottery retailer receives a 5% commission on gross sales. Retailer commissions in Fiscal Year 2007 totaled over \$233,000.



Lottery Products



- Played in 13 Lottery jurisdictions including Montana.
- In Fiscal Year 2007, Montana Hot Lotto sales totaled \$3.9 million.
- Hot Lotto prizes paid in Fiscal Year 2007 totaled almost \$1.9 million, including eight players who won \$10,000.
- In Fiscal Year 2007, overall prize percentage for Hot Lotto was 48%.
- Total number of winners in Fiscal Year 2007 was approximately 23,000.
- Each Lottery retailer receives a 5% commission on gross sales. Retailer commissions in Fiscal Year 2007 totaled nearly \$195,000.



- Qwik Tix games, available only in Montana, are instant win games printed by the Lotto terminal.
- There are four Qwik Tix games — Lucky Numbers, Hot-Tac-Toe, Jacks or Better, and Montana Match.
- In Fiscal Year 2007, Qwik Tix sales totaled \$454,000. Qwik Tix prizes paid in Fiscal Year 2007 totaled approximately \$270,000.
- In Fiscal Year 2007 overall prize percentage for Qwik Tix was 60%.
- Total number of winners in Fiscal Year 2007 was approximately 35,000.
- Each Lottery retailer receives a 5% commission on gross sales. Retailer commissions in Fiscal Year 2007 totaled over \$22,000.

20 Years By The Numbers



On June 24, 1987, Montana Lottery retailers sold their first Scratch ticket, Pot of Gold. This game sold for \$1, and offered a top prize of \$10,000.

First Scratch game offered, on June 24, 1987, was Pot of Gold.

Since June 1987, the Montana Lottery has sold more than \$200 million in Scratch tickets, and paid out prizes for Scratch games of more than \$110 million. Twenty years later, many things have changed in the way the Montana Lottery conducts its business. More than 20 Scratch games are actively on sale at any one time. The most popular games are Crossword and Bingo, which offer players extended play value. In August 2006, the Lottery introduced its first \$10 ticket, when it introduced the concept of a "Family of Games" which are four related games, selling for \$1, \$2, \$5 and \$10. These games have similar graphics and play style and have lots of winners in the top prize categories as well as throughout the prize structure.

\$141 million to state programs.

In May 2007 a second \$10 was introduced, in celebration of the Montana Lottery's 20th Anniversary. This game features holographic paper, a top prize of \$100,000, the largest ever offered in a Scratch game in Montana, and contains images that reflect the first game, Pot of Gold.

In addition to Scratch games, three multi-state games, Powerball, Wild Card and Hot Lotto, are offered. Other multi-state games offered in the past 20 years include Lotto*America, which sold its first ticket in November,

Current terminal-issued games are Powerball, Montana Cash, Wild Card, Hot Lotto, and Qwik Tix.

1989 and was the first Lotto-type game offered. Daily Millions, Rolldown, Tri-West Lotto and Cash for Life enjoyed limited lifespans, but produced additional sales for Lottery retailers, and additional revenue for important state programs.

Terminal-issued games previously offered by the Montana Lottery are Lotto*America, Rolldown, Tri-West Lotto, Cash 4 Life, and Daily Millions.

The two Montana-only games ever offered besides Scratch games are Montana Cash and Qwik Tix. Montana Cash has enjoyed popularity with Montanans for more than 17 years, and has produced more than 350 jackpot winners. Qwik Tix, an instant-win game sold through the Lottery terminals, went on sale in January 2004, and offers players the best odds for the terminal games with a selection of four different games—Montana Match, Jacks or Better, Hot Tac Toe and Lucky Numbers. These games all offer a top prize of \$500.

More than 350 Montana Cash players have won jackpots ranging from \$20,000 to \$280,000. The game went on sale in May, 1991.

Montana Lottery games have generated 14 million-dollar winners in its 20-year history. Total prize payouts are more than \$305 million. In addition, the Lottery's network of retailers has earned more than \$35 million.



20 Years By The Numbers

Direct game costs total over \$67 million, and include the cost of printing Scratch games and the equipment and communications costs of operating the Lottery's terminal network. Administrative costs for operating the Lottery total approximately \$67 million, and have remained under 10% for the past ten years.

**\$47 million Lotto*American
Prize won in November
1991 in Havre is the largest
prize paid in Montana.**

Most importantly, profits from the sale of these games have generated more than \$140 million to help support important state programs. This is a profit margin of more than 20 percent, a margin that few businesses can match. Prior to 1992, proceeds were designated to elementary and secondary schools, the Teachers' Retirement System, and the Board of Crime Control for administrative costs associated with juvenile detention centers. Since 1992, the Lottery's proceeds are transferred to the State's General Fund.

**Fourteen Montana Lottery
players have won \$1
million or more playing the
Montana Lottery (as
of March, 2008).**

From The Commission



In Fiscal Year 2007, the Lottery commission was pleased to observe and participate in the Montana Lottery's most successful year ever. With record sales and record transfers to the State of Montana General Fund, our 20th Anniversary exceeded expectations, with revenue of \$1.6 million more than Fiscal Year 2006 and a 25 percent increase in transfers to the state. This makes our 20-year totals to important state programs more than \$140 million.

The Commission salutes the hard work of the entire Lottery staff. Even more significantly, the Commission would like to take this opportunity to recognize the sizeable contributions of the retail network for the past 20 years.



Back row, Wilbur Rehmann, Helena; Craig Anderson, Sheriff, Glendive
Front Row, Beth O'Halloran, Missoula; Robert Crippen, CPA, Chair, Butte;
Thomas M. Keegan, Attorney at Law, Helena

The Montana Lottery Commission is a five-member board appointed by the Governor to staggered four-year terms. By law, one member must be licensed to practice law in the State of Montana; one must have five years' experience in law enforcement; and one must be certified public accountant. The commission meets at least quarterly.



Independent Auditor's Report

To the Commissioners
Montana State Lottery
Helena, Montana

We have audited the accompanying financial statements of the Montana State Lottery (the Lottery), an enterprise fund of the State of Montana, as of and for the years ended June 30, 2007 and 2006. These financial statements are the responsibility of the Lottery's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note A, the financial statements present only the Lottery and are not intended to present the financial position of the State of Montana and the results of its operations and cash flows of its proprietary fund types in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Lottery, an enterprise fund of the State of Montana, as of June 30, 2007 and 2006, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued a report dated November 9, 2007 on our consideration of the Lottery's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The Management's Discussion and Analysis on pages 8 through 10 are not a required part of the basic financial statements but are supplementary information required by the accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

Galuska, Higgins & Galuska, PC
GALUSHA, HIGGINS AND GALUSHA, PC
Certified Public Accountants and Advisors

Helena, Montana
November 9, 2007

Management's Discussion & Analysis



The following *Management Discussion and Analysis* of the Montana State Lottery's (Lottery) activities and financial performance provides the reader with an introduction to and overview of the financial statements for the fiscal years ended June 30, 2007 and 2006. We encourage readers to consider this information in conjunction with the financial statements, which directly follow.

Fiscal Year 2007 Highlights

The Montana Lottery completed another successful fiscal year with the highest level of sales ever reported for both scratch and online products. With a new focus on scratch products including a family of games concept with \$1, \$2, \$5 and \$10 price points, the Lottery saw a 10% increase in overall scratch sales. While the Lottery did not experience significantly high Powerball jackpots, sales of online products including Hot Lotto, Wild Card and Montana Cash exceeded expectations. Hot Lotto and Wild Card sales were up 41% and 31% respectively over fiscal year 2006 sales.

In fiscal 2007, the Lottery's revenues reached a record new high of \$41.5 million. This resulted in a transfer to the General Fund of \$11.4 million, the largest in the history of the Lottery.

Overview of the Financial Statements

The Lottery is classified as a special-purpose government fund engaged only in business-type activities. Accordingly, the Lottery operates in much the same manner as commercial enterprises using the full accrual method of accounting in accordance with accounting principles generally accepted in the United States of America. The basic financial statements consist of two components:

- 1) Three Fund Financial Statements: a *Statement of Fund Net Assets*, a *Statement of Revenues, Expenses, and Changes in Fund Net Assets*, and a *Statement of Cash Flows*; and
- 2) Notes to the Financial Statements.

The *Statement of Fund Net Assets* provides information about the nature and amounts included in both short-term and long-term assets and liabilities at the end of the year. Long-term fixed assets are capitalized and depreciated over their useful lives. Because the Lottery is required to transfer all "profits," or the excess of assets over liabilities, to the State's General Fund, its "net assets" will always be zero.

The *Statement of Revenues, Expenses, and Changes in Fund Net Assets* includes all of the current years' revenues and expenses. Revenues are recognized when earned and become measurable, not when they are received. Expenses are recognized when incurred, not when paid. This statement measures the success of the Lottery's operations over the past two years and details the total amount transferred to the General Fund.

The final statement is the *Statement of Cash Flows*. The primary purpose is to provide information about the cash receipts and payments during the reporting period. The statement also reports changes in cash resulting from operations, investing and financial activities, and provides answers to questions such as where cash came from and what cash was used for.

Net Assets

The table below presents a summary of the Lottery's *Statement of Fund Net Assets*.

CONDENSED STATEMENTS OF FUND NET ASSETS
AS OF JUNE 30,

	2007	2006	Dollar Change	Percentage Change
Current Assets	\$ 4,863,257	\$ 4,724,396	\$ 138,861	2.9%
Capital Assets Net of Depreciation	139,127	125,608	13,519	10.8%
Other Assets	1,509,968	1,394,278	115,690	8.3%
Total Assets	\$ 6,512,352	\$ 6,244,282	\$ 268,070	4.3%
Current Liabilities	\$ 5,344,334	\$ 4,922,739	\$ 421,595	8.6%
Long-Term Liabilities	1,168,018	1,321,543	(153,525)	-11.6%
Total Liabilities	\$ 6,512,352	\$ 6,244,282	\$ 268,070	4.3%
Invested in Capital Assets, Net of Related Debt	\$ 139,127	\$ 125,608	\$ 13,519	10.8%
Unrestricted Fund Net Assets	(139,127)	(125,608)	(13,519)	10.8%
TOTAL FUND NET ASSETS	\$ 0	\$ 0	\$ 0	0%



Management's Discussion & Analysis

The change in Current Assets is due to an increase in receivables and an increase in inventories. The increase in receivables is a result of an increase in games with higher price points and an increase in the time frame for settlement for these higher price-point games. Two other increases in receivables are a result of a receivable from Multi State Lottery Association that did not occur in fiscal year 2006 and a receivable for Short Term Investment Pool interest since June 30, 2007 was on a Saturday.

The change in Other Assets is due to an increase of approximately \$115,000 in the Multi-State Lottery reserve fund.

The major change in Current Liabilities is an increase in the amount due to the General Fund as a result of operations and an increase in accounts payable due to the timing of the

receipt of bills. The decrease in Long-Term Liabilities is a result of a decrease in the MUSL prize liability.

The category, *Invested in Capital Assets, Net of Related Debt*, consists of capital assets less accumulated depreciation, amortization and the outstanding balance on the debt related to the purchase of these assets, if any. Since the Lottery is required to transfer the total results of operations to the General Fund, the Net Assets should always be \$ - 0 - and the Unrestricted category is just a balancing figure. This figure can be used to measure asset liquidity and demonstrates where and if the Lottery's funds are obligated.

Operations and Changes in Net Assets

The table below presents a summary of the Lottery's Operations for the last two years.

CONDENSED STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN FUND NET ASSETS FOR THE YEARS ENDED JUNE 30

	2007	2006	Dollar Change	Percentage Change
Total Operating Revenues	\$ 41,568,729	\$ 39,928,912	\$ 1,639,817	4.1%
Total Direct Game Costs	<u>27,277,893</u>	<u>27,009,013</u>	<u>268,880</u>	<u>1.0%</u>
Net Operating Revenue	\$ 14,290,836	\$ 12,919,899	\$ 1,370,937	10.6%
Total Operating Expense	3,135,347	4,009,362	(874,015)	-21.8%
Net Operating Income	\$ 11,155,489	\$ 8,910,537	\$ 2,244,952	25.2%
Total Non-Operating Revenues (Expenses)	264,753	199,918	64,835	32.4%
Income before Transfer	\$ 11,420,242	\$ 9,110,455	\$ 2,309,787	25.4%
Transfer to General Fund	<u>\$ 11,420,242</u>	<u>\$ 9,110,455</u>	<u>\$ 2,309,787</u>	<u>25.4%</u>
Changes In Net Assets	\$ 0	\$ 0	\$ 0	0%

Montana Cash, Wild Card, Scratch tickets and Qwik Tix all experienced modest increases in sales, while Powerball decreased slightly. Direct Game Costs, which include prizes, vendor fees, retailer commissions, and scratch ticket printing, are directly related to sales and therefore, also show an overall increase with the exception of vendor fees which decreased as a result of the new contract with Intralot.

Total Operating Expenses decreased 21%. Individual expense categories varied somewhat with both increases and decreases. Specific categories with changes of note were Depreciation and Amortization and Multi-State Lottery Association dues.

The income from Non-Operating activities increased from the previous year. This category includes interest received from investments and gains or losses on the sale of non-current assets. The interest received on investments increased by approximately \$67 thousand and changes due to the sale of non-current assets were negligible.

The increase in sales and decrease in operating expenses resulted in the Lottery transferring over \$11.4 million to the General Fund.

Management's Discussion & Analysis



Capital Assets and Debt Administration

The Lottery follows the State's policy of capitalizing long-term assets with an historical value of \$5,000 or more. In fiscal year 2007, the Lottery's capital assets were divided into two categories: 1) a fleet of vehicles used by the sales staff, and 2) office or computer equipment.

Capital assets are depreciated using the straight-line method over the appropriate estimated useful life, ranging from three to seven years.

In fiscal year 2007, the Lottery purchased two replacement vehicles and a trailer for \$44,624 and a color printer for \$5,490.

The Lottery currently has no debt-related commitments.

Looking Ahead

The Lottery's goal is to maximize revenue for the State's programs while maintaining the public trust in lottery gaming. This requires offering games that Lottery players want to play, providing convenient locations for the purchase of tickets, and controlling operating expenses.

The Lottery begins new scratch games on a regular basis. In fiscal year 2007, 45 games featuring different graphics, play styles, and prizes levels were placed at our retailer sales locations, including a new \$10 game, *Lucky Times 10*, designed to commemorate the Montana Lottery's 20th Anniversary on June 24. The Lottery estimated that 40 new scratch games will be introduced in fiscal year 2008. We plan to continue building scratch sales through innovative game themes, higher price points, and product advertising.

The Lottery will continue to look for opportunities to meet the expectations of our players for new and interesting games. On October 1, 2007, we will introduce a limited-lifetime game, called *Montana Millionaire*. This game will sell 150,000 tickets through the Lottery terminal. During the first two months of sales, four \$5,000 prizes will be given away. The Grand Prize drawing, which will be held on December 31, 2007, will give one \$1 million prize, five \$100,000 prizes, and five \$10,000 prizes. We anticipate additional revenue to the State of approximately \$900,000. We also will continue our efforts to increase the number of retail outlets throughout the state with new terminal placements, and with emphasis on Powerball's Power Play option and some Wild Card advertising.

Exceptional increases in lotto revenue are usually the result of higher jackpots; however, such jackpots cannot be predicted nor depended upon to occur at any specific time. Therefore, omitting the possibility of a record jackpot, the Lottery projects that the transfer to the General Fund in fiscal year 2008 will be approximately \$12 Million.

Contacting the Lottery's Financial Management

This financial report is designed to provide a general overview of the Lottery's finances for all of Montana's citizens, taxpayers, players and creditors, and to report on the Lottery's accountability for its funds. Questions concerning any of the information provided in this report or requests for additional information should be addressed to: Montana Lottery, 2525 N. Montana Avenue, Helena, MT 59601.



Financial Statements

STATEMENTS OF FUND NET ASSETS JUNE 30,

	2007	2006
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	\$ 1,839,056	\$ 2,365,054
Accounts receivable, net of allowance	1,381,754	904,280
Due from primary government	859	-
Due from component units	-	376
Inventory	1,614,375	1,394,354
Collateral securities on loan	-	33,830
Other current assets	<u>27,213</u>	<u>26,502</u>
Total current assets	<u>4,863,257</u>	<u>4,724,396</u>
FURNITURE AND EQUIPMENT		
Furniture and equipment	421,703	411,670
Accumulated depreciation	<u>(282,576)</u>	<u>(286,062)</u>
Total furniture and equipment	<u>139,127</u>	<u>125,608</u>
OTHER ASSETS		
MUSL Prize Reserve fund	<u>1,509,968</u>	<u>1,394,278</u>
TOTAL ASSETS	<u><u>\$ 6,512,352</u></u>	<u><u>\$ 6,244,282</u></u>
LIABILITIES AND FUND NET ASSETS		
CURRENT LIABILITIES		
Accounts payable	\$ 654,938	\$ 298,499
Estimated prize liability	1,600,412	1,565,401
Liability for securities on loan	-	33,830
Transfer obligations to general fund	2,853,513	2,709,470
Due to primary government	9,140	6,602
Deferred revenue	107,068	203,786
Current portion of accrued compensated absences	<u>119,263</u>	<u>105,151</u>
Total current liabilities	<u>5,344,334</u>	<u>4,922,739</u>
LONG-TERM LIABILITIES		
MUSL prize liability	1,105,943	1,241,969
Long-term portion of accrued compensated absences	<u>62,075</u>	<u>79,574</u>
Total long-term liabilities	<u>1,168,018</u>	<u>1,321,543</u>
TOTAL LIABILITIES	<u><u>\$ 6,512,352</u></u>	<u><u>\$ 6,244,282</u></u>
COMMITMENTS AND CONTINGENCIES	-	-
FUND NET ASSETS		
Invested in capital assets, net of related debt	139,127	125,608
Unrestricted fund net assets	<u>(139,127)</u>	<u>(125,608)</u>
TOTAL FUND NET ASSETS	<u>-</u>	<u>-</u>
TOTAL LIABILITIES AND FUND NET ASSETS	<u><u>\$ 6,512,352</u></u>	<u><u>\$ 6,244,282</u></u>

The accompanying notes are an integral part of these financial statements.

Financial Statements



STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN FUND NET ASSETS FOR THE YEARS ENDED JUNE 30,

	<u>2007</u>	<u>2006</u>
OPERATING REVENUES		
Scratch ticket games	\$ 12,404,645	\$ 11,239,757
Terminal ticket games	29,159,946	28,678,657
Miscellaneous	4,138	10,498
Total operating revenues	41,568,729	39,928,912
DIRECT GAME COSTS		
Scratch ticket prize expense	7,345,750	6,656,048
Terminal ticket prize expense	14,071,166	14,071,484
Retailer commission	2,469,427	2,328,531
Gaming vendor fees	2,489,916	3,083,535
Cost of tickets sold	901,634	869,415
Total direct game costs	27,277,893	27,009,013
Income before operating expenses	14,290,836	12,919,899
OPERATING EXPENSES		
Advertising	617,124	493,318
Advertising production	108,443	229,616
Communications	90,980	87,879
Audit fees	32,013	71,483
Contractual services	95,106	112,391
Depreciation and amortization	31,164	790,777
Management fees	54,014	53,942
MUSL operating fees	6,077	72,333
Other	13,330	38,262
Public relations	67,156	37,110
Personal services	1,621,816	1,619,432
Repairs and maintenance	15,702	11,101
Supplies and materials	217,426	240,410
Utilities and rent	113,036	113,336
Travel	51,960	37,972
Total operating expenses	3,135,347	4,009,362
OPERATING NET INCOME	\$ 11,155,489	\$ 8,910,537
NON-OPERATING REVENUES (EXPENSES)		
Interest income	\$ 267,019	\$ 199,910
Securities on loan income	212	1,985
Securities on loan expense	(211)	(1,977)
Loss on disposal of furniture and equipment	(2,267)	-
Total non-operating net income	264,753	199,918
INCOME BEFORE TRANSFERS	\$ 11,420,242	\$ 9,110,455
TRANSFERS OUT		
General fund	11,420,242	9,110,455
Total transfers out	11,420,242	9,110,455
Fund net assets, beginning of year	-	-
Fund net assets, end of year	\$ _____ -	\$ _____ -

The accompanying notes are an integral part of these financial statements.



Financial Statements

STATEMENTS OF CASH FLOWS FOR THE YEARS ENDED JUNE 30,

	2007	2006
CASH FLOWS FROM OPERATING ACTIVITIES		
Cash received from sales	\$ 40,997,135	\$ 40,469,526
Cash paid to suppliers for goods and services	(7,497,307)	(8,360,589)
Cash paid to employees	(1,619,055)	(1,598,501)
Cash paid for prizes	(21,333,107)	(20,631,970)
Net cash provided by operating activities	<u>10,547,666</u>	9,878,466
CASH FLOWS FROM INVESTING ACTIVITIES		
Interest and dividend income	<u>249,484</u>	113,879
Net cash provided by investing activities	<u>249,484</u>	113,879
CASH FLOWS FROM NON-CAPITAL FINANCING ACTIVITIES		
Transfers out:		
General fund	(11,276,198)	(7,927,224)
Net cash used by non-capital financing activities	<u>(11,276,198)</u>	(7,927,224)
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Purchase of fixed assets	(50,114)	(49,115)
Proceeds from sale of fixed assets	3,164	-
Net cash used by capital and related financing activities	<u>(46,950)</u>	(49,115)
NET INCREASE/DECREASE IN CASH AND CASH EQUIVALENTS	<u>(525,998)</u>	2,016,006
Cash and cash equivalents, beginning of year	<u>2,365,054</u>	349,048
Cash and cash equivalents, end of year	<u>\$ 1,839,056</u>	<u>\$ 2,365,054</u>
RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES		
Operating income	<u>11,155,489</u>	8,910,537
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation and amortization	31,164	790,777
Changes in assets and liabilities:		
(Increase) decrease in:		
Accounts receivable	(477,475)	445,621
Due from primary government	(859)	9
Due from component units	376	(55)
Inventory	(220,021)	(293,501)
Collateral securities on loan	33,830	(33,830)
Other current assets	(711)	(4,792)
Long-term receivable	(115,690)	(68,142)
Interest receivable included in long-term receivable	17,537	86,040
Increase (decrease) in:		
Accounts payable	356,437	(227,289)
Lottery prizes payable	(101,014)	113,108
Liability for securities on loan	(33,830)	33,830
Deferred revenue	(96,718)	103,152
Due to primary government	2,538	(1,316)
Due to component units	-	(5)
Compensated absences payable	(3,387)	24,322
Net cash provided by operating activities	<u>\$ 10,547,666</u>	<u>\$ 9,878,466</u>

The accompanying notes are an integral part of these financial statements.

Notes To The Financial Statements



Note A – Summary of Significant Accounting Policies

Organization - The Montana State Lottery (hereafter referred to as the Lottery) was created in November 1986 by a referendum vote of the people of Montana.

Section 23-7-101, Montana Code Annotated (MCA) establishes the provision of the code under which the Lottery operates. The Lottery is overseen by a five-member commission consisting of Montana residents appointed by the Governor. The Commission, by law, has the power to operate a state lottery, determine the type and forms of lottery games, set ticket prices, determine the number and size of prizes, conduct lottery drawings, enter into agreements to offer lottery games with other states, and prepare financial reports. The Lottery is attached to the Department of Administration for administrative purposes.

Disposition of revenue is a minimum of 45 percent for prizes and a maximum of 10 percent for commission to sales agents. The remaining revenues, less expenses, are transferred to the Montana State General Fund.

Reporting Entity - The Lottery is included in the State of Montana's financial statements as an enterprise fund. In accordance with governmental accounting and financial reporting standards, there are no component units to be included within the Lottery's financial statements as a reporting agency.

Basis of Accounting - The Lottery utilizes the accrual basis of accounting and is classified as an enterprise fund of the governmental proprietary fund type. Enterprise funds account for operations similar to private business enterprises where the intent of the Legislature is that costs are to be financed or recovered primarily through user charges, or where the Legislature has decided that periodic determination of revenue earned, expenses incurred or net income is appropriate.

Revenue Recognition - Sales of scratch lottery tickets are made to licensed retailers who market the tickets to the public on a commission basis. Revenue is recognized when tickets are activated by retailers. Tickets activated, but not sold by retailers, may be returned for credit. Sales are reduced for estimated ticket returns.

Sales of terminal issued tickets, Powerball, Wild Card, Hot Lotto, Qwik Tix and Montana Cash, are made through licensed retailers who market the tickets on a commission basis using computerized terminals. Revenue is recognized on drawing dates for Powerball, Wild Card, Hot Lotto and Montana Cash. Tickets sold in advance of future drawing dates are recorded as deferred revenue until the ticket becomes valid for a drawing. Qwik Tix revenue is recognized at the time of the sale by the retailer through the terminal.

Cash and Cash Equivalents - Cash and cash equivalents consist of interest-bearing deposits with the Montana Board of Investments short-term investments pool, cash deposited with banks and cash on deposit with the Montana State Treasurer that is part of the State's pooled cash and is not separately identifiable as to specific types of securities. These funds are highly liquid and may be drawn on daily.

Allowance for Uncollectible Accounts - The Lottery uses the allowance method to account for uncollectible receivables. The allowance is based on management's estimate of possible bad debts.

Advertising Costs - Advertising costs are expensed as incurred.

Allowance for Returned Tickets - The Lottery's policy is to accept any unplayed scratch ticket from a retailer for credit without regard to when the ticket or pack of tickets was activated. Therefore, an allowance to recognize the possibility of returns is calculated at the end of each fiscal year.

Inventory - Inventory consists of tickets and supplies. Ticket inventory includes scratch lottery tickets that are carried at cost using the specific identification method. Tickets are charged to cost of sales when activated. Unsold tickets are charged to cost of sales upon the end or cancellation of the related game. Supply inventory is carried at cost and expensed as used.

Prizes - Prize expense is recognized based on a predetermined prize structure for each scratch ticket and terminal game. Free tickets, when used as part of a game's prize structure, are recorded as a reduction in revenue and not as prize expense.

Unclaimed Prizes - Prizes for Powerball, Wild Card, Hot Lotto, and Montana Cash must be claimed within six months after the appropriate draw date. Prizes for Qwik Tix must be claimed within six months of the sales date. Prizes for scratch games must be claimed within six months of the announced end of each game. The unclaimed prize amounts are taken as a reduction in the Lottery Prizes Payable liability and the Prize Expense and are transferred to the State of Montana General Fund as a portion of the quarterly transfer. The combined amounts of unclaimed prizes for terminal games were \$743,977 and \$614,524 and for the scratch games were \$444,373 and \$343,447 for the fiscal years ended June 30, 2007 and 2006, respectively.



Notes To The Financial Statements

Note A – Summary of Significant Accounting Policies (cont.)

Intangible Assets - Intangible assets consisted of software for the old gaming system. This software was purchased in 1999 and had an original cost of \$1,150,000 and was being amortized over seven years. Amortization was complete as of March 2006.

Furniture and equipment - Furniture and equipment are recorded at cost. Donated furniture and equipment are recorded at their estimated fair market value at the date of donation. Ordinary maintenance and repairs are charged to operations as incurred; major renewals and betterments are capitalized. Upon disposition or retirement of furniture and equipment, the cost and related accumulated depreciation or amortization are removed from the accounts. Gain or loss on disposal is reflected in nonoperating revenues and expenses. Depreciation and amortization are calculated on a straight-line basis over estimated useful lives of three to seven years. The Lottery conforms to the State of Montana capitalization threshold for recording furniture and equipment. This threshold is \$5,000.

Compensated Absences - State employees earn vacation leave ranging from fifteen to twenty-four days per year based on years of service. Vacation leave may be accumulated to a total not to exceed twice the maximum number of days earned annually. Sick leave accumulates at a rate of twelve days per year with no maximum accumulation. Upon retirement or termination, an employee is paid for 100 percent of unused vacation leave and 25 percent of unused sick leave.

Use of Estimates - The preparation of financial statements in conformity with Generally Accepted Accounting Principles (GAAP) requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

Note B – Cash and Cash Equivalents

Cash and cash equivalents consist of the following:

	June 30,	
	2007	2006
Short-term investment pool	\$1,583,133	\$2,062,806
Cash on deposit with State Treasurer	245,773	292,098
Cash in revolving deposit account	10,000	10,000
Petty cash	150	150
	<u>\$1,839,056</u>	<u>\$2,365,054</u>

The Lottery participates in the Montana Board of Investments Short Term Investment Pool (STIP). STIP balances are highly liquid investments with maturities of 397 days or less. The bank balance of the revolving deposit account was \$19,067 and \$19,221 at June 30, 2007 and 2006, respectively, and was covered by federal depository insurance up to \$100,000. The carrying amounts reported in the Statements of Fund Net Assets for cash and cash equivalents approximate the fair market value.

Note C – Investment Risk Disclosures

Effective June 30, 2005, the State of Montana implemented the provisions of Governmental Account Standards Board (GASB) Statement No. 40, *Deposit and Investment Risk Disclosures*. The Lottery participates in two investment pools: the Multi-State Lottery Association (MUSL) reserve accounts and the State of Montana's Short Term Investment Pool (STIP). There are four types of risk that must be disclosed. These risks are defined below followed by their applicability to each of the investment pools.

Credit risk is defined as the risk that an issuer to an investment will not fulfill its obligation, i.e., not make timely principal and interest payments.

Custodial credit risk is the risk that the Lottery would not be able to recover the value of the investment or collateral securities that are in the possession of an outside party in the event of the failure of that party.

Concentration of credit is the risk of loss attributed to the magnitude of a government's investment in a single issuer.

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment.

Multi-State Lottery Association

The MUSL investment policy for prize reserve and unreserved funds states that permitted investments "include direct obligations of the United States government, perfected repurchase agreements, and obligations issued or guaranteed as to payment of principal and interest by agencies or instrumentalities of the United States government, and mutual funds of approved investments." Obligations of the U.S. government or obligations explicitly guaranteed by the U.S. government are not considered to have credit risk nor concentration of credit risk per GASB Statement No. 40.

Notes To The Financial Statements



Note C – Investment Risk Disclosures (cont.)

Multi-State Lottery Association (cont.)

The securities are held in trust for MUSL by Mellon Trust. This large diversified institution has several national offices, with the Everett, Massachusetts office handling the MUSL account. Interest rate risk is minimized by requiring that the average portfolio maturity be no more than 1.33 years and that the maximum maturity for any one security cannot exceed 5 years.

Short-term Investment Pool

All short-term funds are held in the State's Short Term Investment Pool (STIP) administered by the Board of Investments (BOI). A summarized description of their disclosure follows and full details may be obtained by contacting the Montana Board of Investments, 2401 Colonial Drive, P.O. Box 200126, Helena, MT 59620-0126.

For STIP securities, BOI's policy to manage credit risk requires securities have the highest investment grade rating in the short-term category by at least one Nationally Recognized Statistical Rating Organization (NRSRO). The six NRSROs include Standard and Poors, Moody's, Duff and Phelps, Fitch, IBCA and Thompson's Bank Watch.

Per the BOI, all STIP securities are registered in the nominee name for the Montana Board of Investments and held in the possession of the Board's custodial bank. The STIP investment policy does not specifically address concentration of credit risk. As of June 30, 2007, there were no single issuer investments that exceeded 5% of the STIP portfolio. Per GASB Statement No. 40, interest rate disclosures are not required for STIP since STIP is a 2a-7-like pool.

Under the provisions of state statutes, the BOI has, by a Securities Lending Authorization Agreement, authorized the custodial bank, State Street Bank, to lend BOI's securities to broker-dealers and other entities with a simultaneous agreement to return the collateral for the same securities in the future. During the period the securities are on loan, BOI receives a fee and the bank must initially receive collateral equal to 102% of the market value of the securities on loan and must maintain collateral equal to not less than 100% of the market value of the loaned security. BOI retains all rights of ownership during the loan period. At year-end, the BOI had no credit risk exposure.

Note D – Accounts Receivable

Accounts receivable consists of the following:

	June 30,	
	2007	2006
Interest receivable	\$ 17,741	\$ -
Accounts receivable	1,553,021	1,032,683
Allowance for returned tickets	(189,008)	(128,403)
	<u>\$1,381,754</u>	<u>\$ 904,280</u>

Note E – Inventory

Inventory consists of the following:

	June 30,	
	2007	2006
Scratch tickets	\$1,487,491	\$1,295,163
Supplies	126,884	99,191
	<u>\$1,614,375</u>	<u>\$1,394,354</u>

Note F – Other Current Assets

Other current assets consist of the following:

	June 30,	
	2007	2006
Prepaid Expenses	\$27,213	\$25,034
Employee Travel Advances	-	1,468
	<u>\$27,213</u>	<u>\$26,502</u>

Note G – Furniture and Equipment

A summary of furniture and equipment for the Lottery is as follows:

	June 30, 2006	Additions	Deletions	June 30, 2007
Furniture, fixtures and equipment	\$411,670	\$ 50,114	\$ (40,081)	\$ 421,703
Accumulated depreciation	(286,062)	(31,164)	34,650	(282,576)
	<u>\$ 125,608</u>	<u>\$18,950</u>	<u>\$ (5,431)</u>	<u>\$ 139,127</u>



Notes To The Financial Statements

Note H – Multi-State Lottery Association (MUSL)

Joint Venture Association - In November 1989, the Lottery joined the Multi-State Lottery Association (MUSL). MUSL was created in September 1987 to operate a multi-state lottery game for the benefit of party lotteries. The Powerball game, Wild Card game and Hot Lotto game are presently the only games operated jointly by the members in which the Lottery participates. Each lottery participating in MUSL is represented on the Board of Directors.

Prize Reserve Fund Receivable/Payable - As a member of the MUSL, the Lottery is required to contribute to various prize reserve funds maintained by MUSL. The contributions are to be used to fund unanticipated prize claims. All funds remitted and the related interest earnings will be returned to the Lottery upon leaving the association, less any portion of unanticipated prize claims, which was paid from the fund.

The Lottery contributes to the reserve fund through the set-aside for prizes. Payments made to the reserve fund are considered a portion of the prize expense associated with each game.

During 1990, the MUSL Board created the unreserved accounts to record interest earned on the various prize reserve funds when the prize reserve fund balance is not below the predetermined ceiling amount. The amounts in the unreserved accounts may be used at the Board's discretion.

The long-term receivable balance of \$1,509,968 and \$1,394,278 at June 30, 2007 and 2006, respectively, represents the Lottery's share of the MUSL prize reserve fund that had a balance of \$119,550,256 and \$119,976,521 for 2007 and 2006, respectively. The long-term liability balance of \$1,105,943 and \$1,241,969 at June 30, 2007 and 2006, respectively, represents the Lottery's share of the total estimated prize liability.

Lotto*America Prizes and Investments - Prizes awarded to Lotto*America grand prize winners are paid in twenty annual installments funded by investments in United States Treasury zero coupon bonds. Bonds purchased on behalf of Montana source winners are held in trust by MUSL with the Montana State Lottery as beneficiary. As the bonds mature, the proceeds are forwarded to the Lottery and distributed to the grand prize winners on the anniversary date of each win.

At June 30, 2007 and 2006, MUSL held United States Government zero coupon bonds in trust for the Lottery winners with respective par values of \$29,125,949 and \$34,333,949 and respective market values of \$25,227,505 and \$28,920,120.

The Lottery has eight Lotto*America/Powerball/Tri-West winners. The combined total future prize payments owed is \$29,260,000 and \$34,468,000, at June 30, 2007 and 2006, respectively. The present value of future prize payments approximates the current market value of the bonds held in trust for the Lottery winners.

Total annual payments due as of June 30, 2007 are:

2008	\$ 5,208,000
2009	5,208,000
2010	5,106,000
2011	4,603,000
2012	2,155,000
Thereafter	6,980,000
	<u>\$ 29,260,000</u>

Multi-State Lottery Association Financial Position -

Information related to the Multi-State Lottery Association's audited financial statements is as follows:

	June 30,	
	2007	2006
Total assets	\$ 972,391,954	\$ 1,054,179,556
Total liabilities	\$ 972,194,562	\$ 1,053,967,990
Total net assets	197,392	211,566
Total liabilities and net assets, unrestricted	\$ 972,391,954	\$ 1,054,179,556
Total revenues	\$ 14,334,698	\$ 10,780,028
Total expenses	3,049,852	2,708,215
Increase (decrease) in unrestricted net assets	\$ 11,284,846	\$ 8,071,813

Note I – Estimated Prize Liability

The estimated prize liability represents the Lottery's estimate of prizes payable related to games in process at year-end based on the predetermined prize structure of each outstanding game.

Notes To The Financial Statements



Note J – Obligation to Transfer Funds

The Lottery is required to transfer its net revenue to the Montana State General Fund. This change was enacted through the passage of SB 83 by the 1995 Legislature and signed into law by Governor Racicot in April 1995. Transfer obligations outstanding at June 30, 2007 and 2006 were \$2,853,513 and \$2,709,470, respectively.

Note K – Long-Term Liabilities

Long-term liabilities consist of the following:

	June 30,			
	Current	Long-Term	2007 Total	2006 Total
Prize liability MUSL	\$ -	\$1,105,943	\$1,105,943	\$1,241,969
Accrued compensated absences	119,263	62,075	181,338	184,725
	<u>\$ 119,263</u>	<u>\$1,168,018</u>	<u>\$1,287,281</u>	<u>\$1,426,694</u>

Note L – Leases

The Lottery leases its office, administrative and warehouse facilities under a non-cancelable lease agreement that is effective September 2007 through August 2017. Rent expense under operating leases charged to operations was \$91,511 and \$90,160 for the years ended June 30, 2007 and 2006, respectively.

The future minimum lease payments under operating leases that have remaining terms in excess of one year are as follows:

2008	\$ 116,979
2009	124,937
2010	128,685
2011	132,546
2012	136,522
Thereafter	<u>773,066</u>
	<u>\$ 1,412,735</u>

Note M – Employee Benefit Plans

Pension Plan - The Lottery participates in the Public Employees Retirement System (PERS). PERS is a statewide mandatory cost-sharing multiple employer retirement plan which covers all employees. The plan is established under State law and is administered by the State of Montana. The plan provides disability and death benefits to plan members and beneficiaries as well as a choice of a defined benefit or a defined contribution retirement plan.

The plan issues a publicly available financial report that includes financial statements and required supplementary information. The report may be obtained from the following address: Public Employees Retirement System, Montana Public Employees Retirement Administration, P.O. Box 200131, 100 N. Park, Suite 220, Helena, MT 59620-0131, (406) 444-3154.

The contribution rate for the plan is required and determined by State law. The contribution rate for fiscal years 2007 and 2006, expressed as a percentage of covered payroll, was 6.9% for both years, for both the employer and the employees. The amounts contributed to the plan during the years ended June 30, 2007 and 2006, were \$166,090 and \$165,494, respectively, and were equal to the required contributions for each year.

Deferred Compensation Plan - The Lottery's full-time regular employees are eligible to participate in the State of Montana's deferred compensation plan. The plan is administered by Benefits Corporation on behalf of Great West Life Insurance Company through a contract with the State of Montana. The amount of compensation deferred is not available to employees until termination, retirement, death, or unforeseen emergency. All amounts are deferred under the plan created under Internal Revenue Code Section 457 and Title 19, chapter 50, Montana Code Annotated (MCA). Assets of the deferred compensation plan are required to be held in trusts, custodial accounts or insurance company contracts for the exclusive benefit of participants and their beneficiaries.

Note N – Related Party Transactions

During the ordinary course of business, other State agencies provide certain services and supplies to the Lottery. During 2007 and 2006, total payments to other State agencies were approximately \$174,219 and \$211,589, respectively.



Notes To The Financial Statements

Note 0 – Commitments, Contingencies and Subsequent Event

Scratch Tickets - The Lottery has an agreement with Oberthur Gaming Technologies Corp. to print scratch game tickets. The contract expires August 8, 2008. On May 2, 2007, Scientific Games, Inc. bought Oberthur Gaming Technologies Corp. The Lottery incurs approximately \$1,100,000 per year under this contract.

Terminal Vendor - The Lottery is contracted with Intralot, Inc. to provide for the operation of the gaming system through March 30, 2013. The contract provides for three one year extensions, if agreeable by both parties. The contract price is 5.8% of each \$1 ticket sold, which is an estimated total contract price of approximately \$17 million over the seven-year contract. The contract price includes the cost of equipment.

Advertising - The Lottery signed a contract with Banik & Associates to provide advertising services for \$5,500 per month through December 2007.

Independent Observation of Drawings - The Lottery is committed to Galusha, Higgins and Galusha, PC, to observe Montana Cash and other special drawings. The original term of the contract was for three years ending June 30, 2005. Compensation did not exceed \$25,000 for the three year period. The contract was renewed for a three year period ending June 30, 2008. Compensation under the new agreement will not exceed \$30,000.

Audit of Financial Statements - The Lottery is party to a contract with Galusha, Higgins and Galusha, PC, an independent accounting firm, to audit the Lottery's annual financial statements. The yearly contract was finalized on June 7, 2007. Compensation for the years ended June 30, 2007 and 2006 will not exceed \$12,000.

Prize Contingencies - Certain Big Spin prizes awarded are payable to the winners in annual installments spanning seventeen to twenty years with the first payment being made by the Lottery. The Lottery has entered into agreements with an insurance carrier under which purchased annuities will provide the required level of payments corresponding to the Lottery's obligation to these prize winners. Because it is the intent of the Lottery that the insurance carrier will make future installment payments directly to each prize winner, neither the present value of the annuities nor the present value of the future payments are reflected in the accompanying financial statements. The Lottery would be liable for such future payments in the gross amount of \$-0- and \$232,500 at June 30, 2007 and 2006, respectively, if the insurance carrier defaulted on their payments.

Note P – Risk Management/Public Entity Risk Pool

The Lottery contributes to the Group Employee Comprehensive Medical and Dental Plan and the Property and Casualty Insurance plans of the State of Montana. Details of these plans can be found in the State of Montana Comprehensive Annual Financial Report available through the Department of Administration's website at www.mt.gov/doa/afsd/cafr/cafr.asp.

Independent Auditor's Report



INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*

To the Commissioners
Montana State Lottery
Helena, Montana

We have audited the financial statements of Montana State Lottery (Lottery), an enterprise fund of the State of Montana, as of and for the year ended June 30, 2007, and have issued our report thereon dated November 9, 2007. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Lottery's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Lottery's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Lottery's internal control over financial reporting.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material

misstatement of the financial statements will not be prevented or detected by the entity's internal control.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Lottery's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information of the Lottery's Commissioners, management, and the Legislative Audit Committee and is not intended to be and should not be used by anyone other than those specified parties.


GALUSHA, HIGGINS AND GALUSHA, PC
Certified Public Accountants and Advisors

Helena, Montana
November 9, 2007



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